

# Employee vs. Independent Contractor



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# Employee vs. Independent Contractor

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- Who are employees for employment tax purposes?
- Section 530 of the Revenue Act of 1978
- Classification Settlement Program
- IRC Section 7436



# Types of Employees

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- Common law or specific tax statute
- Identified as an employee under a Section 218 Agreement
- Identified as employee under state or local law
- Status may differ for FICA and for Federal income tax withholding

# Employment Under the Internal Revenue Code



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- IRC Sec. 3121(d)(2) Common law test
- IRC Section 3121(d)(3) Other employees by statute
- IRC 3401(c) Officer, employee, or elected official of government
- Reg. 1.1402(c)-2(b) Holder of public office is not self-employed



# Examples of Public Officials

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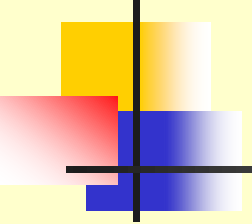
- Mayor
- Legislator or elected representative
- County commissioner
- Judge/justice of the peace
- County or city attorney, marshal, sheriff, constable
- Registrar of deeds
- Tax collector or assessor
- Road commissioner
- Board members



# Fee-Based Public Officials

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- Individuals who receive their income solely from fees received directly from the public are subject to self-employment tax and are not employees
- If fees are received by government and paid over to the official, they are considered wages paid to an employee



# Common-Law Employee

## Reg. Sec. 31.3121(d)-1(c)

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Generally the employer-employee relationship exists when the person for whom services are performed has **the right to control and direct** the individual who performs the services, not only as to result, but also as to details and means.



# Control Test

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- Worker subject to control as to:
  - What is to be done
  - How it is to be done
  - Employer may allow broad freedom, but retains right to control





# Tests Under Common Law

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The IRS recognizes three categories of facts to consider when making a determination of employee status:

- Behavioral control
- Financial control
- Relationship of the parties

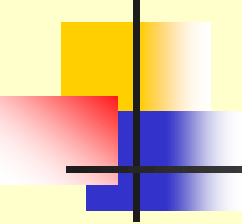
# Behavioral Control

Facts that indicate whether entity has a right to direct and control how work is performed

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- Instructions provided
- Training provided
- Government identification (i.e., badge)
- Nature of occupation
- Evaluation systems

# Financial Control



Facts that indicate whether entity controls business and financial aspects of worker activities

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- Significant investment in equipment, tools, or facilities
- Unreimbursed expenses
- Offers service to general public
- Method of payment (by job vs. by hour, etc.)
- Opportunity for profit or loss
- Part-time vs. full-time status
- Worker has corporate status

# Relationship of the Parties

Facts to consider in determining how the parties view the relationship

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- Can refuse payment for nonperformance
- Provide fringe benefits
- Discharge/termination rights
- Permanency
- Regular business activity
- Work is integral to business



# Form SS-8

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- If you are not sure whether a worker is an employee or independent contractor, you can complete Form SS-8 and send it to IRS for determination
- Information requested from worker and payer
- Not an examination, or re-examination of previously examined returns



# Section 530

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Refers to Section 530 of the Revenue Act of 1978; not an IRC provision

- Originally one-year provision, extended indefinitely
- May terminate taxpayer's employment tax liability with respect to an individual not treated as an employee



# Section 530 - Examinations

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- IRS must notify taxpayer at beginning of examination of section 530
- Publication 1976 should be provided
- Taxpayer does not need to make request to be eligible for section 530 treatment

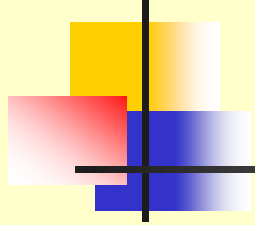


# Section 530 Requirements

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- Reporting consistency
- Substantive consistency
- Reasonable basis





# Reporting Consistency

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- Filing all required Federal tax returns on a basis consistent with treatment of individual as not being an employee
- Employers that do not timely file Forms 1099-MISC cannot receive section 530 relief for those workers for that year



# Substantive Consistency

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- Treating all workers in similar positions the same
- Cannot be claimed if taxpayer has treated any individual holding substantially similar position as an employee



# Reasonable Basis

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- Business must have reasonably relied on one of the following--
  - Prior audit
  - Judicial precedent
  - Industry practice
  - Other reasonable basis



# Section 3509

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- Special rates for employee share of tax
- Employer cannot recover employee share of taxes
- Employer remains liable for full employer share of taxes
- Employee liability for FICA tax not affected



# Section 3509

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- Available for Section 218 workers
- Counsel Guidance - Program Manager  
Technical Advice 2009-034
- Not available for intentional disregard
- No 3402(d) relief provisions



# 3509 Rates

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- If Form 1099-MISC was filed:
  - 20% of employee social security rate
  - 20% of employee Medicare rate
  - 1.5% of compensation FITW rate
- If Form 1099-MISC was not filed:
  - 40% of employee social security rate
  - 40% of employee Medicare rate
  - 3% of compensation FITW rate



# Classification Settlement Program (CSP)

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- Provides standard agreement for closing examination agreements
- Only available for worker classification issues
- CSP consideration is mandatory in worker reclassification cases
- Acceptance is voluntary



# CSP Resolution

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- Settlement offer is based on Section 530 analysis
- Program offers a graduated settlement AND
- Prospective compliance





# CSP Exclusions

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## Exclusions:

- Information Returns not timely filed
- A prior closing agreement on same issue
- Wage issues



# CSP – More Exclusions

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Exclusions (continued):

- Litigation/Judicial Proceedings
- Fraud/Criminal Investigations
- Third Party Arrangements



# CSP Settlement Offers

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3 types of Settlement Offers:

- 100% of tax for 1 year + prospective compliance
- 25% of tax for 1year + prospective compliance
- No tax + prospective compliance (530)

More than one can apply to each case



# Classification Settlement Program (CSP)

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- Prospective compliance generally begins in the next quarter
- No Forms W-2 are required
- If the CSP offer is rejected normal audit procedures continue
- CSP offer is extended in the appeals process